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C O N F I D E N T I A L SECTION 01 OF 05 CARACAS 000614

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E.O. 12958: DECL: 05/18/2019
TAGS: ECON EFIN VE
SUBJECT: U.S. COMPANIES COULD LOSE HUNDREDS OF MILLIONS AS
CADIVI'S BACKLOG GROWS

REF: A. CARACAS 397
¶B. CARACAS 564
¶C. CARACAS 52
¶D. CARACAS 547

Classified By: Acting Economic Counselor Richard T. Yoneoka, for
reasons 1.4 (b) and (d).

¶1. (SBU) Summary: U.S. companies stand to lose hundreds of millions of dollars, if not more than one billion dollars, as the backlog at CADIVI grows. The government of the Bolivarian Republic of Venezuela (GBRV) maintains currency controls, and CADIVI is the GBRV agency that determines who receives dollars at the official exchange rate. There are three principal ways U.S. and other multinational companies operating in Venezuela are exposed to CADIVI: through imports booked at the official rate and awaiting final CADIVI authorization; through requests to remit profits at the official rate; and through airline ticket sales. In each case the potential loss may come if the company does not receive CADIVI's authorization for a pending request and is forced to turn to the parallel foreign exchange market to obtain dollars. Given the current difference between the two exchange rates, the losses could be as high as 67 cents on the dollar. Unfortunately, private companies have limited legal recourse in Venezuela, and Post does not have the ability to intercede on U.S. companies' behalf. End summary.

CADIVI: Rationing Dollars...

¶2. (U) Since 2003, the GBRV has maintained currency controls, essentially rationing the foreign currency individuals and companies can obtain at the official exchange rate. CADIVI is the GBRV agency created to administer the rationing process. If a company wants to exchange bolivars (Bs) for dollars at the official rate (currently 2.15 Bs/USD), for example to import goods or repatriate profits, it needs CADIVI's approval. Whenever there are currency controls, an alternative foreign exchange market exists, and Venezuela is no exception. Companies can also exchange bolivars for dollars on the parallel market, as the alternative foreign exchange market is called in Venezuela. As the parallel exchange rate is currently 6.5 Bs/USD, it is obviously far preferable to obtain dollars through CADIVI. The "CADIVI dollar", as Venezuelans call it, is the best deal in town for those who can get it, and demand for CADIVI dollars has skyrocketed.

¶3. (SBU) Supply of CADIVI dollars is highly dependent on oil prices. CADIVI approvals peaked, as did oil prices, in the summer of 2008, at approximately USD 210 million per working day (equivalent to USD 53 billion on an annual basis). Approvals have since fallen to a daily average of USD 117 million in the first quarter of 2009 (equivalent to USD 29.6 billion on an annual basis), a decline of 44 percent from the summer 2008 peak. Most analysts expect CADIVI approvals to fall further. To implement this cut, CADIVI has been prioritizing imports, particularly food and medicine (ref A). Many other requests have remained pending for months or even years. While bribes, lobbying, and/or political considerations have undoubtedly played a role in some approvals, we do not believe CADIVI is systematically favoring or discriminating against companies based on national origin.

...And Repeating History?

¶4. (U) For Venezuelans, and for companies with experience in Venezuela, CADIVI is nothing new. Venezuelans have lived through two prior periods of currency controls, 1983-1989 (administered by RECADI) and 1994-1996 (administered by OTAC). In each case, the controls proved unsustainable, with the administering agency unable to provide enough dollars and the parallel rate skyrocketing. Both periods ended in severe devaluations and fiscal adjustments. More importantly for the subject of this cable, both also ended with multinational companies incurring losses as the administering agency, particularly in the case of OTAC, failed to make good on

implicit dollar commitments at the prevailing official exchange rate.

U.S. COMPANIES: TYPES OF EXPOSURE

¶5. (SBU) We estimate the stock of U.S. companies' current exposure to CADIVI at several billion dollars. There are three major types of exposure, all related to U.S. companies with operations in Venezuela that account in dollars at the official rate for bolivar transactions. These exposures are in the areas of imports, profit remittance, and airline ticket sales. Companies are dependent on CADIVI authorization to receive the dollars corresponding to a given transaction at the exchange rate at which the transaction was booked. If CADIVI does not approve a given request, or if CADIVI approves the conversion after a devaluation takes place, the company would be forced to exchange the bolivars for dollars at a worse than anticipated exchange rate, thus incurring a loss. (Note: It is more difficult to estimate the rate of change of U.S. companies' exposure to CADIVI, i.e. the flow, than it is to estimate current exposure, i.e. the stock. We are sure exposure is growing, but we do not know how fast. End note.)

A Stylized Example

¶6. (U) To give a stylized example, let's say Company USA - Venezuela, the Venezuelan subsidiary of Company USA, recorded profits of Bs 215 in 2008 (the example would be similar for imports or airline ticket sales as well). These profits would appear in Company USA's consolidated 2008 balance sheet as net income of USD 100, given the prevailing official rate of exchange. Yet in order for Company USA actually to receive USD 100, should it want to receive the full value of the profits as a cash dividend, CADIVI would have to approve Company USA - Venezuela's request to convert the bolivars into dollars. If CADIVI does not act on the request, Company

USA - Venezuela might choose to convert the bolivars to dollars at the parallel foreign exchange rate. At the current parallel rate, if Company USA converted its 2008 profits today it would receive only USD 33, thus incurring a "foreign exchange" loss of USD 67, or 67 percent of previously booked profits.

Imports

¶7. (C) For companies conducting imports through CADIVI, exposure occurs during the window after the company has made the import with the initial approval of CADIVI (known as the "AAD") and before CADIVI has issued final authorization (known as the "ALD") for the Central Bank to release the dollars. Companies' exposure has been growing: the time between the import taking place and the ALD being issued has been increasing, as has the monetary value of corresponding accounts payable. Some information shared by U.S. companies (strictly protect all company information throughout) over the past several months includes: General Motors - waiting for ALDs worth USD 800 million; Ford - waiting for ALDs worth USD 250 to 300 million; Chrysler - waiting for ALDs worth 180 million; Colgate Palmolive - waiting for ALDs worth USD 100 million, some of which have been pending over a year; Proctor and Gamble - waiting for ALDs worth USD 150 million; Pfizer - waiting for ALDs worth 23 million, with an average wait of 100 days; and Merck - waiting for ALDs worth USD 10-12 million, with an average wait of 60 days. Based on these figures, we estimate the total exposure of U.S. companies to CADIVI for imports at around USD two billion, if not more.

¶8. (C) Based on conversations with a range of U.S. and other companies, we believe the structure of imports is undergoing a fundamental shift from the CADIVI process (i.e., accessing the official exchange rate) to the parallel market. The extent to which this shift is taking place depends on the company and the products it imports. Pfizer, for example, imports only products on CADIVI's priority list and has not made any imports on the parallel rate. Proctor and Gamble

has moved 10 to 15 percent of its imports to the parallel market, and General Mills, which brings in high value-added foods under its own brands, has moved almost entirely to the parallel market. Many companies whose goods are not on CADIVI's priority list have told us they would welcome a complete shift to the parallel market as long as it was transparent, applied to everyone, and did not affect imports with outstanding ALDs.

¶9. (C) We believe exposure of U.S. companies exporting to Venezuela is more limited because of the way deals are structured. If CADIVI does not approve an ALD, the importing company, or, secondarily, its local bank would have to find alternative means of paying the U.S. exporter. To ensure payment, U.S. exporters and their U.S. banks are generally requiring a line of credit, and increasingly foreign assets or even cash as collateral, from the importing companies and their local Venezuelan banks. As CADIVI will only issue an ALD if the exporter has not been paid, however, exporters are waiting increasingly longer to receive payment. Cisco, for example, has accounts receivable worth USD 37 million and averaging 200 days from Venezuelan distributors waiting for CADIVI ALDs. (Note: Important exceptions to the generally limited exposure of the U.S. exporter are intra-company transfers and cases where the U.S. parent company provides a guarantee for imports made by its Venezuelan affiliate. End note.)

Dividends

¶10. (C) Thanks to strong economic growth, a fixed official

exchange rate that has not changed since March 2005, and high local inflation, many U.S. companies booked record earnings and profits in Venezuela in the past four years. They are now struggling to repatriate these profits as dividends through CADIVI at the official rate. Some companies are waiting for CADIVI approval for 2007 dividends, while others have received this approval. (CADIVI has not approved repatriation of any 2008 dividends; indeed, many companies have just finished their 2008 dividend submission.) Examples of U.S. companies with outstanding requests include: Colgate Palmolive - USD 92 million from 2007; Pfizer - USD 30 million for 2007; General Motors - USD 300 million; Ford - USD 157 million; Merck - USD 20 million for 2007; Heinz - USD 20 million for its 2007-2008 fiscal year; and Oracle - USD 35 million (includes royalties as well). Given these figures and the fact that they do not include 2008 dividends in most cases, it seems a reasonable assumption that total exposure of U.S. companies to CADIVI for dividend remittance is near USD 1 billion.

¶11. (SBU) U.S. companies have taken different approaches to dealing with the growing possibility they will not receive authorization to remit profits at the current official rate. Most companies have not resorted to the parallel market because of the write-down they would have to take, but a few have. For example, the transcript of a Kimberly-Clark 2009 first quarter earnings teleconference with analysts strongly suggests the company repatriated dividends at the parallel rate, and one financial journalist estimates they booked losses of roughly USD 50 million on the transaction. Many companies are choosing to reinvest their profits locally or are hedging by buying real estate or moving into a new headquarters building. Other companies are keeping all or part of their profits in local bank accounts, which pay minimal interest. A handful of multinational companies are making use of financial instruments that essentially allow them the option of converting bolivars to USD at the parallel rate prevailing when they invested in the instrument, while keeping the investment on their books as bolivars to avoid booking a loss (as the bolivars would be converted to USD at the official rate in their accounting systems) and in the hopes they will receive CADIVI approval.

Airlines

¶12. (C) Airlines are a separate category under CADIVI. Foreign carriers operating flights to Venezuela may request

conversion to hard currency of bolivar revenues in excess of local expenses. As they cannot charge in USD for tickets sold in Venezuela, and as the bolivar price of a ticket sold in Venezuela must match at the official rate the USD price of the same ticket sold abroad (excluding certain fees), all customers who can purchase tickets in bolivars. (For example, a USD 1,000 ticket bought in the U.S. would cost Bs 2,150 if purchased locally. Since Bs 2150 is approximately USD 330 at the parallel rate, the customer effectively saves 67 percent.) American Airlines, by far the largest of the three U.S. carriers operating in Venezuela, has outstanding claims of approximately USD 140 million and is currently experiencing a lag of six months in CADIVI approvals. All airlines have some restrictions on the types of tickets that can be purchased in Venezuela; recently American and Continental stopped selling tickets in Venezuela for itineraries originating in the U.S.

Other Categories

¶13. (C) There are other types of exposure to CADIVI to which U.S. companies and institutions are susceptible, though they do not match the scale of the categories mentioned above.

These include reimbursement for royalties, credit card use, and tuition payments. (Note: In the case of credit cards, CADIVI delays in reimbursing local banks for their customers' authorized credit card use abroad have caused limited exposure for Visa and Master Card, as well as for Citibank, the only large U.S. bank with a subsidiary in Venezuela. End note.) The problems experienced by U.S. and other multinational oilfield services companies in collecting from PDVSA (ref B), however, have nothing to do with CADIVI problems except in the general sense that both have been severely aggravated by the fall in oil prices.

Legal Recourse

¶14. (SBU) Companies with requests pending with CADIVI have little recourse in Venezuela's legal system. The decree governing foreign investment allows for repatriation of profits and capital, but this provision is subject to currency controls, should they exist (ref C). Of equal significance, Venezuela's legal system is increasingly subordinate to the state's interests (ref D), which would make it very difficult for any company to win a case against CADIVI or the GBRV, even if the law were on its side. An ongoing legal case related to the previous currency control regime gives companies further incentives not to pursue such cases. In 2003, American Airlines lost a suit it brought in 1996 seeking compensation for losses due to foreign currency claims that were not honored as OTAC was collapsing. American ultimately dropped its appeal on the initial claim but continues to appeal the court's ruling that it pay GBRV legal expenses as assessed by the court.

¶15. (SBU) Many U.S. and multinational companies have structured their operations in Venezuela such that they enjoy the protection of one of Venezuela's approximately 23 bilateral investment treaties (BITs). According to a prominent local lawyer, many of these treaties provide a sufficient legal basis for a company to seek remittance of profits or capital at the official rate via international arbitration, should CADIVI not approve the company's request. As our contact noted, however, in practice should a company take this step it would likely mean the end of doing business in Venezuela, as the GBRV would almost certainly take steps to drive it out of the country.

USG Options

¶16. (SBU) Our options for helping U.S. companies currently waiting for CADIVI authorizations are extremely limited. Direct advocacy with the GBRV is unlikely to work for multiple reasons. First, we have next to no access: the Charge's request for a meeting with CADIVI's president has gone unanswered for over three months. Second, while we have

no reason to believe CADIVI is discriminating against U.S. companies, there is also no reason to believe CADIVI would treat U.S. companies preferentially, particularly given President Chavez's frequent anti-U.S. tirades. The problem is that CADIVI simply does not have enough dollars available to honor valid outstanding requests and keep an adequate pipeline of new requests flowing. Post noted the problem CADIVI poses for repatriation of dividends and capital in the 2009 investment climate statement (ref C), and Embassy officers discuss all problems associated with CADIVI in informal conversations with U.S. companies considering doing business in Venezuela or with Venezuelan companies.

Comment

¶17. (SBU) While currency controls and other types of government intervention pose a barrier to entry for U.S. and other international companies, U.S. companies already operating in Venezuela are adjusting to the reality of limited CADIVI dollars. Local managers of U.S. subsidiaries generally say their headquarters are concerned but not frantic about their subsidiaries' CADIVI exposure, and the subsidiaries themselves are taking some steps to reduce or mitigate this exposure. Despite the problems within CADIVI and the economic distortions introduced by currency controls, few local observers expect the GBRV will lift the controls anytime soon. As such, the best strategy for U.S. companies seeking to maintain a long-term presence in Venezuela is probably to gradually unwind their exposure to CADIVI, understanding that they may be forced to register losses in the hundreds of millions if not billions of dollars. End comment.
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